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In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 525

HYMAN MOORE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 1-9) is not reported. The opinion of the Court of Appeals (R. 16-19) is reported at 170 F. 2d 191.

JURISDICTION

The judgment of the Court of Appeals was entered November 1, 1948. (R. 20.) The petition for a writ of certiorari was filed January 28, 1949. The jurisdiction of this Court rests upon 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's decision that business income earned by taxpayer and attributed to his wife as a "partner" was includible in taxpayer's gross income as defined in Section 22 (a) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

These appear in the Appendix, *infra*, pp. 11-13.

STATEMENT

The facts as found by the Tax Court (R. 1-8) may be summarized as follows:[1]

In 1938 taxpayer and one Scherr became equal stockholders of a corporation which engaged in the wholesale wine business. The corporation was organized with a capital of $3,000, of which half was contributed by taxpayer and the other half by Scherr and his wife. Of the $1,500 which taxpayer invested, $1,000 was borrowed by him from a bank on the endorsement of his brother, and $500 was given to him by his father-in-law at the request of his wife. In 1939 the corporation began to distribute beer as well as wine, and needed additional capital. Scherr and his wife invested another $2,000, and the taxpayer did likewise. The additional $2,000 invested by taxpayer was borrowed

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[1] This is one of two companion cases which were consolidated for hearing before the Tax Court. (R. 1.) The Tax Court overruled the Commissioner's determination in the other case (*Isaac Scherr* v. *Commissioner*), and the Commissioner did not appeal from that decision. The Tax Court's findings are summarized insofar as they relate to this case.

from his mother. (R. 2.) In 1941 the corporation was dissolved, and the business was continued as a partnership with taxpayer and Scherr as the partners. (R. 5.)

From the inception of the business taxpayer and Scherr spent most of their time away from the office, selling and delivering wine and beer. Several other salesmen were also employed. The office and warehouse were run by Mrs. Scherr, who worked long hours daily and knew the business completely. (R. 3-4.) Taxpayer's wife had one child in 1937 and another in 1942; up until 1942 she assisted Mrs. Scherr in the office, but because of her home responsibilities she did not come to the office regularly. Shortly before her second child was born in 1942, she stopped doing any work for the business, and Mrs. Scherr then engaged a full time office assistant. (R. 4.)

In 1942 Scherr was seriously injured and his wife demanded a partnership interest in the business. Scherr discussed it with taxpayer, who requested a similar interest for his wife. They agreed to make the wives partners and communicated this decision to their accountant, who advised them that such arrangement would also afford a tax advantage. (R. 5-6.) On or about January 1, 1943, taxpayer and Scherr and their respective wives executed a partnership agreement which provided, among other things, that capital was to be contributed equally by the four of them; that profits and losses

were to be shared equally; that each was to devote full time to the business, at compensation to be mutually agreed upon; that checks were to be signed jointly by taxpayer and Scherr, or by a person authorized by them; that profits were to be divided and distributed at times "mutually determined"; and that the spouse of any retiring partner had the right to purchase his or her interest at a valuation determined by "inventory and accounting". (R. 6, 11-14.) At the time of this agreement the capital of the business was $19,618.66. Taxpayer and his wife were each credited with $4,933.25, while Scherr and his wife were each credited with $4,876.08. The husbands filed gift tax returns reporting gifts to their respective wives of the amounts of capital credited to them, and the wives filed donee returns. The firm's bank and Dun & Bradstreet were advised of the formation of the new partnership, and books were set up showing partnership interests of the wives. (R. 6-7.)

Shortly after the formation of this new partnership Mrs. Scherr raised the question of her right to sign checks and the bank was notified that her signature should be accepted as co-signer with either taxpayer or Scherr. (R. 7.)

Both capital and services were essential to the business. Mrs. Scherr contributed to the business carried on during the taxable years both capital originating with her and vital services. Taxpayer's wife contributed neither. (R. 7-8.)

In their income tax returns for 1943 and 1944 (the taxable years) taxpayer and Scherr treated the partnership income as distributable in equal shares to them and their wives. For 1943 the partnership income amounted to $127,142.65, and for 1944 it amounted to $33,527.72. (Tr. 6, 15.) The Commissioner determined that the husbands were the sole partners and that the income was therefore taxable entirely to them. (R. 1, Tr. 10-11.) Taxpayer and Scherr each petitioned for a redetermination and the cases were consolidated for hearing before the Tax Court. (R. 1.) The Tax Court held that Scherr's wife became a real partner for tax purposes, and overruled the Commissioner's determination as to him. It held otherwise as to taxpayer's wife. (R. 8-9.) Taxpayer appealed from the decision in his case; the Commissioner did not appeal from the decision in the *Scherr* case. The Court of Appeals affirmed. (R. 16-19.)

ARGUMENT

The decision below is fully in accord with *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293. There is no occasion for further review.

1. The question here is identical with that decided in the *Tower* and *Lusthaus* cases, *supra.* This Court there held that a valid gift by a husband to his wife of a portion of his business capital, followed by a valid partnership agreement between

them, did not necessarily render the wife his partner for federal income tax purposes. The "basic question" is who "earned" the business income; unless the wife contributes either "capital originating with her" or "vital additional services" (managerial or otherwise) or both (*Commissioner* v. *Tower*, *supra*, pp. 283, 289, 290), the Tax Court is justified in concluding that all the business income is earned by, and hence taxable to, the donor-husband. "The statutes of Congress designed to tax income actually earned because of the capital and efforts of each individual member of a joint enterprise are not to be frustrated by state laws which for state purposes prescribe the relations of the members to each other and to outsiders". *Commissioner* v. *Tower*, *supra*, p. 288. The *Tower* and *Lusthaus* decisions are but an application of the familiar *Earl-Clifford-Horst*[2] principles in the sphere of family partnerships, and were recognized as such in *Commissioner* v. *Sunnen*, 333 U. S. 591, 606.

The Tax Court found that taxpayer donated one-half of his one-half interest in a partnership to his wife contemporaneously with her admission as a partner (R. 6-8), but that his wife contributed "neither capital originating with her nor vital services" (R. 9). Applying the *Tower* and *Lusthaus* principles, it held that the share of the business income for the taxable years ascribed to and

[2] *Lucas* v. *Earl*, 281 U. S. 111; *Helvering* v. *Clifford*, 309 U. S. 331; *Helvering* v. *Horst*, 311 U. S. 112.

reported by the donee-wife as a "partner" remained taxable to taxpayer. (R. 8-9.)[3] Since taxpayer's wife admittedly (Pet. 2) contributed neither capital of her own nor vital services,[4] and hence earned none of the income in question, affirmance of the Tax Court's decision by the court below (R. 16-19) was clearly correct. This case is essentially no different from many other family partnership cases in which income ascribed to a donee-partner has been held taxable to the donor-taxpayer, and in which certiorari has been denied.[5]

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[3] In the companion *Scherr* case, the Tax Court found that Mrs. Scherr had contributed both capital of her own and vital services, and accordingly overruled the Commissioner's determination that she was not a real partner. (R. 7-8.)

[4] Although taxpayer contended before the Tax Court that his wife contributed $500 of her own (R. 9), he now concedes the correctness of the Tax Court's finding to the contrary (Pet. 2). With respect to the wife's services, both courts below found that the business from its inception had been managed and conducted by taxpayer, Scherr, and Mrs. Scherr; while taxpayer's wife performed some non-vital part-time services until 1942, in that year (which was prior to the taxable years) she ceased performing even these minor services. (R. 3-4, 18-19.)

[5] See, *e.g.*, *Fletcher* v. *Commissioner*, 164 F. 2d 182 (C.A. 2d), certiorari denied, 333 U. S. 855; *Eisenberg* v. *Commissioner*, 161 F. 2d 506 (C.A. 3d), certiorari denied, 332 U. S. 767; *Wilson* v. *Commissioner*, 161 F. 2d 556 (C.A. 4th) certiorari denied, 332 U. S. 769; *Hash* v. *Commissioner*, 152 F. 2d 722 (C.A. 4th), certiorari denied, 328 U. S. 838, rehearing denied, 328 U. S. 879; *Economos* v. *Commissioner*, 167 F. 2d 165 (C.A. 4th), certiorari denied, 335 U. S. 826; *Scherf* v. *Commissioner*, 161 F. 2d 495 (C.A. 5th), certiorari denied, 332 U. S. 810; *Belcher* v. *Commissioner*, 162 F. 2d 974 (C.A. 5th), certiorari denied, 332 U. S. 824; *Mead* v. *Commissioner*, 131 F. 2d 323 (C.A. 5th), certiorari denied, 318 U. S. 777; *Argo* v. *Commissioner*, 150 F. 2d 67 (C.A. 5th), certiorari denied, 326 U. S. 762; *Sewell's Estate* v. *Commissioner*, 151 F. 2d 806 (C.A. 5th), certiorari denied, 327 U. S. 805; *Sewell* v. *Commissioner*, 151 F. 2d 765 (C.A. 5th), certiorari denied, 327 U. S. 783; *Morton* v. *Thomas*, 158 F. 2d 574 (C.A. 5th) certiorari denied, 330

Nothing has occurred since the denial of certiorari in those cases which calls for further review of this case.[6]

2. In assuming that his wife became a partner for tax purposes because of his gift to her, and irrespective of whether she earned any of the business income, taxpayer advances (Pet. 4-8) the very argument which this Court unequivocally rejected in *Tower* and *Lusthaus*. "If" the wife invests capital of her own or vital additional services, she may be a partner in the tax sense. *Commissioner* v. *Tower*, *supra*, p. 290. To be sure, as taxpayer asserts (Pet. 4-6), there were "relevant facts" in the *Tower* case, in addition to the lack of a contribution of capital or services by the donee-wife, which supported the Tax Court's conclusion that she was not a real partner. But, as is plain from the *Tower* and *Lusthaus* opinions, these factors furnished *cumulative* support for that conclusion. Thus, the existence of a tax avoidance motive, a feature which taxpayer claims was present in *Tower* but

U. S. 834; *Hougland* v. *Commissioner*, 166 F. 2d 815 (C.A. 6th), certiorari denied, 334 U. S. 846; *Lowry* v. *Commissioner*, 154 F. 2d 448 (C.A. 6th), certiorari denied, 329 U. S. 725; *Lorenz* v. *Commissioner*, 148 F. 2d 527 (C.A. 6th), certiorari denied, 327 U. S. 786; *Doll* v. *Commissioner*, 149 F. 2d 239 (C.A. 8th), certiorari denied, 326 U. S. 725; *Nordling* v. *Commissioner*, 166 F. 2d 703 (C.A. 9th), certiorari denied, 335 U. S. 817; *Quon* v. *Commissioner*, 165 F. 2d 215 (C.A. 9th), certiorari denied, 334 U. S. 845; *Earp* v. *Jones*, 131 F. 2d 292 (C.A. 10th), certiorari denied, 318 U. S. 764.

[6] The court below properly declined (R. 17-18) to postpone its affirmance of the Tax Court's decision merely because a bill was introduced at the last session of Congress (Pet. 7) designed to accord tax recognition to partnerships predicated upon intra-family gifts of capital.

absent here (Pet. 5),[7] "simply lends further support to the inference * * * that earnings are really his and are therefore taxable to him and not to his wife." *Commissioner* v. *Tower, supra,* p. 289. Similarly, the other "relevant facts" which taxpayer claims (Pet. 4-5) were present in *Tower* and are absent here[8] are not decisive of the crucial question of who earned the income; their presence in the *Tower* case furnished "more than ample evidence to support the Tax Court's finding that no genuine union for partnership business purposes was ever intended and that the husband earned the income." *Commissioner* v. *Tower, supra,* p. 292. Though the many cases in which claimed family partnerships have been denied tax effect involve different sets of facts, as may be expected, their common denominator lies in the circumstance that the newly admitted partner contributed none of the capital and services which produced the business income.

3. The granting of the Commissioner's petition for certiorari in *Commissioner* v. *Culbertson,* No.

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[7] The Tax Court made no finding one way or the other regarding taxpayer's tax motives, but did find that his accountant advised him that the arrangement would afford a tax saving. (R. 6.) Cf. *Lusthaus* v. *Commissioner, supra.* As the court below noted (R. 18-19), taxpayer's wife was made a partner only because Mrs. Sherr—who contributed both capital of her own and vital services—was made a partner.

[8] In this connection taxpayer gratuitously assumes (Pet. 5) that he relinquished control of the interest he donated to his wife, and that his wife received and used for her own purposes the share of the income attributed to her. Neither of these assumptions is warranted by the record or the Tax Court's findings.

313, does not, as taxpayer asserts (Pet. 3-4), furnish reason for further review of this case. In the *Culbertson* case the Tax Court followed *Tower* and *Lusthaus*, but the Court of Appeals reversed. As pointed out in the Commissioner's petition for certiorari in that case, to permit the reversal to stand would seriously undermine the *Tower* and *Lusthaus* decisions and invite repeated departures from them. See also petition for certiorari in *Commissioner* v. *Hartz*, No. 520. Here both courts below have adhered to *Tower* and *Lusthaus*, and there is no more occasion for further review of this case than of the multitude of similar family partnership cases (fn. 5, *supra*) in which certiorari has been denied.

CONCLUSION

There is no occasion for further review. The decision below is in accord with the controlling decisions of this Court in the *Tower* and *Lusthaus* cases. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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MARCH, 1949

APPENDIX

Internal Revenue Code:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a * * * tax * * *.

(26 U.S.C. 11.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of and business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner,

he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U.S.C. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture or organization.

* * * * *

(26 U.S.C. 3797.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional serv-

ices, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, * * *.

* * * * *

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